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TAGS: [EINV](#) [ECON](#) [CH](#) [TW](#)

SUBJECT: RECHI CASE DRAWS ATTENTION TO LIMITS ON PRC  
INVESTMENT

REF: A. TAIPEI 1924

[B](#). TAIPEI 2743

Classified By: AIT Director Douglas H. Paal, Reason 1.4 b

Summary

1. (C) Investigations of possible illegal investment transactions by Rechi Precision Co., Ltd., the world's third largest manufacturer of compressors for refrigerators and air conditioners, have attracted attention to Taiwan's regulations that limit investment in the PRC to a percentage of net worth. Rechi has already been fined for violating this rule. Many have criticized this regulation, but the Ministry of Economic Affairs (MOEA) and Taiwan Premier Frank Hsieh have stated that the government has no intention at this time of relaxing these restrictions. The restrictions do little to limit the Taiwan economy's dependency on investment in the PRC. More often, they encourage firms to disguise their Mainland investment and may lead more firms to abandon Taiwan and register or list in other jurisdictions such as Hong Kong or Singapore. End summary.

Rechi Under Investigation Blames "Worst Regulation"

2. (U) Rechi Precision Co., Ltd, the world's third largest manufacturer of compressors for refrigerators and air conditioners, attracted media attention this week when its former chairman, Felix S.T. Chen, published an open letter in major Taiwan dailies calling Taiwan's 40 percent cap on investment in the PRC "the worst regulation" for Taiwan investors. Although most people refer to the restriction as a 40 percent cap, Taiwan regulations actually impose a graduated set of percentage restrictions based on a firm's total paid-in capital. Firms with net worth below NTD 5 billion (about USD 150 million) may invest up to NTD 80 million (USD 2.4 million) or 40 percent of net worth whichever is higher. Firms with net worth between NTD 5 billion and NTD 10 billion (USD 300 million) may invest 40 percent of NTD 5 billion plus 30 percent of the firm's net worth over NTD 5 billion. For firms with net worth over NTD 10 billion, they may invest 20 percent of the amount over NTD 10 billion.

3. (U) Rechi is part of the Sampo Group, a large Taiwan conglomerate that makes appliances, computer peripherals, integrated circuits and other electronic components. Rechi was fined NTD 700,000 (about USD 21,000) in the first half of 2005 for violating the PRC investment restrictions. With total net worth of NTD 2.6 billion (about USD 78 million), it was limited to just over NTD 1 billion (about USD 32 million). To comply with the limits, Rechi subsequently increased its net worth in Taiwan.

4. (U) Rechi was originally investigated because of irregular transfers into private bank accounts that caused Taiwan authorities to suspect its executives of embezzling funds. To date the firm has only been fined for excessive investment in the PRC. However, the Financial Supervisory Commission and the Taoyuan Prosecutors Office continue to investigate the firm for possible illegal transactions used to make the investment. In addition, the firm may not have met Taiwan regulations requiring it to report such investment to stockholders.

5. (U) The investigation caused Chen to resign from his positions as chairman of Rechi and the Sampo Group. In September and October, the Taoyuan Prosecutors Office asked him to testify in the case. On November 15, the Prosecutors Office issued a subpoena for Chen to testify. If he does not appear within 30 days a warrant will be issued for his arrest. A Sampo Group spokesman said that Chen was in China and cannot return to Taiwan at this time due to health problems.

6. (U) Interestingly, Taiwan media reported that United Microelectronics Corporation (UMC), Taiwan's second largest contract semiconductor manufacturer, acquired an 8 percent stake in Rechi in October. UMC is under investigation for

possible illegal investment in He Jian, a PRC chip foundry (ref A).

#### PRC Investment Necessary for Rechi's Survival

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17. (U) Chang Chung-ben, a former vice president of Taiwan's China Development Industrial Bank and one of Rechi's original investors, told the press that Rechi's investment in the PRC was necessary for the firm's survival. Before Rechi invested in the Mainland in 2001, it nearly went bankrupt according to Chang. He pointed out that with total demand of 60 million compressors per year, the PRC accounts for 90 percent of the world market. Rechi's investment there was necessary not only to cut costs but more importantly to improve access to the industry's most important market. The firm's competitors from Japan, South Korea, Europe and the United States also have large operations in the Mainland. Chang said that Rechi currently produces 8 million compressors in the PRC annually out of total production of 9 million units.

18. (SBU) A U.S. country risk manager told us this month that U.S. air conditioner manufacturers are now shifting operations out of Korea. Labor costs in Korea for assembling an air conditioner total US\$46 dollars while the same labor costs US\$6 in China. Parts for the air conditioner are about the same in both places, \$46 in Korea and \$47-\$48 in China.

#### Regulation Won't Change Soon

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19. (U) Many businesses and industry organizations have advocated changes to the 40-percent PRC investment cap. According to media reports, Taiwan's Financial Supervisory Commission has proposed to the Executive Yuan that the restrictions be loosened. However, in a hearing before the Legislative Yuan (LY) on November 14, Ministry of Economics Affairs Vice Minister Steve Chen said that the administration has no intention of easing the restrictions at this time, calling the regulations necessary to prevent Taiwan firms from relying too much on the PRC. Premier Frank Hsieh reiterated the point at the LY the following day.

110. (U) Meanwhile, the Taiwan government continues to pursue a policy of "active opening, effective management" when it comes to PRC investment. Recently, the emphasis has been on "effective management" in the form of stronger enforcement of investment restrictions. Taiwan's Investment Commission says that they are currently investigating more than ten other cases of possible illegal investment in the PRC.

#### Taiwan Firms Still Invest Heavily in PRC

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111. (C) Estimates of Taiwan investment in the PRC range as high as USD 200 billion. Taiwan government approved investment in the PRC accounted for 69 percent of the island's total outward investment for the first half of the year. The next largest destination for Taiwan foreign investment, accounting for more than 15 percent of the total, was the British Caribbean, which is often used as a channel for investment ultimately destined for the PRC. Taiwan authorities estimate that as many as 60,000 Taiwan firms have invested in the Mainland -- about three quarters of the total number of firms in Taiwan. More than 70 percent of IT hardware manufactured by Taiwan firms is made in the PRC. Rechi claims that it is now nominally in compliance with the regulations, but still produces almost 90 percent of its output in the Mainland.

#### Comment - Futile, Punishing Transparency, Hurting Taiwan

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112. (C) Even when Taiwan firms comply with the letter of the law, these regulations clearly do very little to limit the dependency of Taiwan firms on investment in the PRC. However, the regulations do change firm behavior. They encourage firms to hide their investment in the PRC entirely or to seek creative means to understate its value and overstate net worth in Taiwan. They encourage firms to use third territories and paper corporations to channel their investments. They also discourage firms from remitting back to Taiwan PRC profits that can be invested locally. In general, these regulations penalize those firms that try to observe them and maintain transparent business practices.

113. (C) In addition, unless changed, these regulations may drive some firms to abandon Taiwan entirely. Electronics conglomerate Hon Hai listed its cell phone manufacturing unit, Foxconn International Holdings, in Hong Kong last February in part to avoid restrictions on PRC investment.

At least 20 other Taiwan firms have also listed in Hong Kong. Semiconductor packaging and testing firm United Test and Assembly Center (UTAC) moved its headquarters from Taiwan to Singapore to avoid an industry specific prohibition on investment in the PRC (ref B). More firms will consider this kind of strategy if Taiwan does not rationalize its cross-Strait investment regulations. End comment.  
Paal